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SUBJECT: AFGHANISTAN - A SPATE OF GOOD ECONOMIC NEWS

REF: Kabul 701

11. (SBU) SUMMARY. Every once in a while, we report good news from Afghanistan. There have been several recent positive developments on the economic front. The government has apparently met conditions for scheduling the fifth Board review under its IMF program, by meeting (and surpassing) the revised FY 2008-09 domestic revenue target and fulfilling three other prior actions. Parliament has passed the FY 2009-10 budget and the Mortgage Law, and the President passed the Negotiable Instruments Law by decree. The economic reform window the U.S. worked hard to establish in the Afghanistan Reconstruction Trust Fund is now a reality. Inflation has dropped sharply. A new commercial bank has been licensed. And a U.S. investor in an OPIC-supported project April 5 signed the first long-term lease of government-owned land under new legal authority enacted last year. END SUMMARY

MEETING IMF CONDITIONS

12. (SBU) The GIROA has met, indeed exceeded, its revised revenue target of Afs 40 billion (\$769 million) for the fiscal year that ended March 21. Deputy Finance Minister Sabit informed us March 29 that the GIROA collected Afs 41.6 billion (\$800 million), representing 56.3 percent of total operating budget expenditures in FY 2008-09. However, this is down from the 66.0 percent of operating budget expenditures covered by domestic revenue sources in FY 2007-08. Sabit noted that revenue collection in the final quarter of the fiscal year was Afs 14 billion (\$269 million), compared with just Afs 9 billion (\$173 million) in each of the other three quarters. Sabit attributes this positive outcome to the institution of daily monitoring of Customs revenues at all posts. Finance Minister Zakhilwal has said the GIROA will implement new revenue measures and seek to surpass the FY 2009-10 revenue target of Afs 51 billion agreed with the IMF. We hope he succeeds, since this would be 54.3 percent of planned operating expenditure, i.e. slightly weaker performance in percentage terms than the GIROA registered in FY 2008-09.

13. (SBU) The Afghan government also fulfilled all three prior actions agreed with IMF staff as conditions for recommending Board completion of the fifth review under the PRGF program. Post understands that the Board will consider the review o/a April 22. Specifically, the GIROA:

-- Passed income tax legislation applying the Business Receipts Tax to imports, adding a levy of 2 percent to most imports. Our business contacts have already complained to us about this tax increase, adding that government officials blamed "IMF and U.S. pressure" when confronted about it.

-- Produced an external auditor's report on the finances of the state-owned electric utility, DABM.

-- Began implementing the MOU between the Commerce and Finance ministries on granting Customs full and unfettered access to the state-owned fuel import depot at Hairatan. This one went down to the wire, and IMF staff showed leniency in not requiring a full two weeks of Customs data (let alone a full month's worth as originally agreed) by the March 21 deadline. We understand MOF produced a report with the available data and plans to deliver additional data in due course. The important thing is that Customs has gained access at Hairatan. Post will continue to monitor implementation of this important revenue-related structural reform.

#### PARLIAMENT PASSES THE BUDGET

¶4. (U) Parliament formally passed the budget for FY 2009-10 on April 11. It calls for total operating expenditures of Afs 94.0 billion (\$1.8 billion), an increase of 27 percent over the FY 2008-09 budget, mainly caused by increases in police and teacher salaries. Security accounts for over 42 percent of total operating expenditure in the new budget, up from about 39 percent last year. Across the board, wages and salaries make up 60 percent of total GIROA operating costs in FY 2009-10. The budget reduces new development spending from the budgeted Afs 112.4 billion (\$2.2 billion) last

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year to Afs 58.1 billion (\$1.1 billion) in FY 2009-10. The budget also carries over Afs 49.7 billion (\$956 million) in unspent funds from the previous fiscal year for a total development expenditure of Afs 108.8 (\$2.1 billion). The Ministry of Finance attributes the low development budget execution rates in FY 2008-09 to the deteriorating security situation and the increased degree of donor preferencing of funds disbursed through the Afghanistan Reconstruction Trust Fund (ARTF).

#### ARTF ECONOMIC REFORM WINDOW ESTABLISHED

¶5. (U) The GIROA and donors have reached final agreement on U.S.-proposed reforms to the recurrent cost window of the Afghanistan Reconstruction Trust Fund (ARTF). Under these reforms, "baseline" recurrent cost support from the ARTF will decline by \$5 million per year from its level of \$276 million in FY 2008-09. Meanwhile, donors have agreed to establish an ARTF Incentive Program, starting at \$40 million in FY 2009-10, to reward GIROA performance against a set of agreed policy benchmarks. These include, for FY 2009-10, benchmarks on sustaining domestic revenues, improving public sector governance, and enabling private sector development. The objective is not only to support the reform process, but also to allow for increased allocations towards the financing of the government's core development programs through the ARTF Investment Window. Mission staff played a key role in securing this important reform.

#### PROGRESS ON COMMERCIAL AND FINANCIAL LAWS

¶6. (U) The upper house of Parliament finally passed the Mortgage Law on March 1, and President Karzai has signed it into law. (The lower house had passed it last November.) Passage should support development of the housing sector. The Law on Negotiable Instruments was recently passed by Presidential decree. The lower house March 28 passed the Law on Secured Transactions for Moveable Property, which now moves to the upper house for review.

#### FINANCIAL SECTOR DEVELOPMENTS

¶7. (U) A new private bank, Ghazenfar Bank, opened for business in March 2009, bringing to 17 the total number of commercial banks (private and state-owned) licensed in Afghanistan. According to the

central bank, total assets of the banking system reached \$2.4 billion in January 2009, an increase of 67 percent compared with January 2008. These banks have a total loan portfolio of \$1 billion, up 37 percent on January 2008, and deposits of \$2 billion, up 69 percent on January 2008. Some 5,000 jobs have been created in the banking sector.

#### INFLATION, RESERVES

¶8. (U) Inflation (year over year) declined from over 40 percent in mid-2008 to just 3.2 percent in March 2009. The GIROA also met both monetary performance criteria (ceiling on currency in circulation and floor on net international reserves) under its IMF program. Gross foreign reserves of the central bank increased by 30 percent over the previous year, reaching \$3.6 billion in March 2009, equivalent to 12 months of imports.

#### LEASING GOVERNMENT LAND

¶9. (SBU) The GIROA last year amended its land-use law to enable long-term lease of government-owned land - up to 50 years for irrigated and 99 years for non-irrigated land. The first (50-year) lease under this new legal authority was signed April 5 by an American investor, Summit Associates, and the Ministry of Agriculture for the land under a milk plant in the northern city of Kunduz. The U.S. Overseas Private Investment Corporation is supporting this project with a loan, and the Mission supported the U.S. investor's efforts to secure a lease on favorable terms. The longer lease periods allowed under the amended law should promote private investment and more rational use of the GIROA's extensive land holdings.

#### COMMENT

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¶10. (SBU) Afghanistan's success in staying on track with its IMF program is highly significant. Nevertheless, not all of these good-news stories represent unalloyed successes. The revenue target achieved by the government had been revised down from the original Afs 44.5 billion agreed to for this year, which the GIROA could not meet. Domestic revenue as a percentage of operating expenses is declining, suggesting that the government's expenses are becoming more fiscally unsustainable and increasing Afghanistan's reliance on donor funding. Customs access to the Hairatan fuel depot needs to be monitored to prevent any back-sliding and extended to all state-owned fuel depots. Numerous commercial laws remain to be passed, and the capacity of the central bank to regulate and supervise the rapidly expanding banking sector needs to be strengthened. Still, given Afghanistan's profoundly challenging economic circumstances, we will take good news where we can get it.

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